

# Strengthening Small & Emerging CDFIs

## The Lending Life Cycle Part One: Customer Acquisition to Loan Closing

Ginger McNally and Tabitha Atkins, Opportunity Finance Network

April 17, 2014

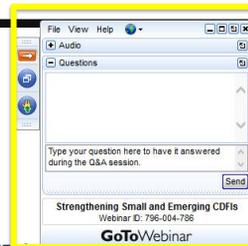


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## GoToWebinar

### CDFI Fund's Capacity Building Initiative

- The Capacity Building Initiative will greatly expand technical assistance and training opportunities for Community Development Financial Institutions (CDFIs) nationwide and significantly boost the ability of CDFIs to deliver financial products and services to underserved communities.
- Industry-wide training will target key issues currently affecting CDFIs and the communities they serve.



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## CDFI Fund's Capacity Building Initiative: Strengthening Small and Emerging CDFIs

- **Goal:** Increase capacity of CDFIs to strengthen financial sustainability and increase community impact.
- **Focus:** Business models that work to support sustainability and impact, understanding stages of organizational growth, and change management.
- **Approach:** Five trainings, five mentored cohorts, one-to-one technical assistance, virtual resource bank.
- **Results:** Each CDFI developed an Action Plan with implementation supported by mentored cohorts.



3

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## Presenter



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4

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## Presenter



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5

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## Strengthening Small & Emerging CDFIs

### The Lending Life Cycle Part One: Customer Acquisition to Loan Closing

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## Agenda

- Define the Lending Life Cycle
- Strategic context for the Lending Life Cycle
- Lending for risk management and efficiency
- Loan origination and customer acquisition
- Loan decisioning process
- Closing the loan
- Lending Life Cycle resources



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## Poll Question

How well do you currently understand the lending life cycle?



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## The Lending Life Cycle

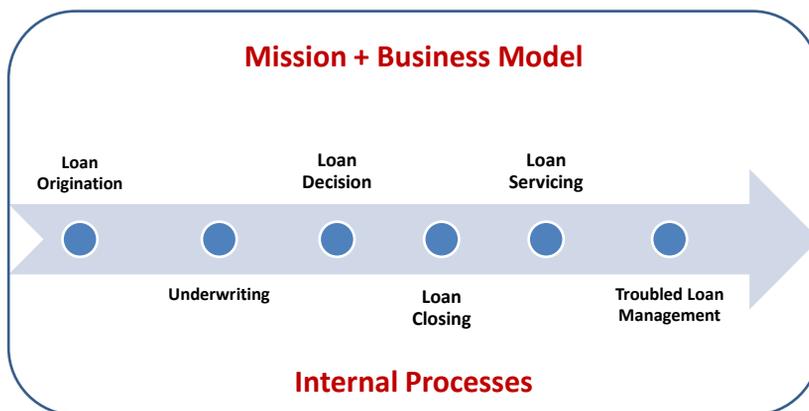
- The lending life cycle starts with the first contact with a potential borrower and continues through their final loan payment
- Who you lend to and how you support your customers throughout the life of their loan reflects and brings to life the mission of your organization



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## Lending Life Cycle



10

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## Understanding the Strategic Context

- The lending life cycle doesn't happen in a vacuum
- To be effective, an organization's lending needs to reflect the mission, strategic priorities and business model of the organization
- This is a dynamic, iterative, ongoing process



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## The Lending Life Cycle – Mission and Business Model

- The **mission** defines why your organization exists
- The **business model** defines how you create value for your customers and for your organization
- Together, the mission and the business model form the **context** for each step of your organization's lending life cycle



12

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# A Tool to Help You Define Your Business Model

The Business Model Canvas can help you get started with defining a business model context for your lending life cycle

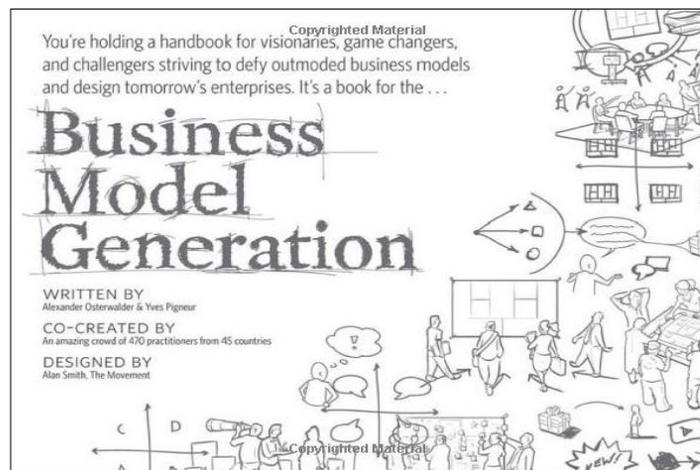
(Source: Business Model Generation, Osterwalder & Pigneur, 2010)



13

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# A Business Model Handbook

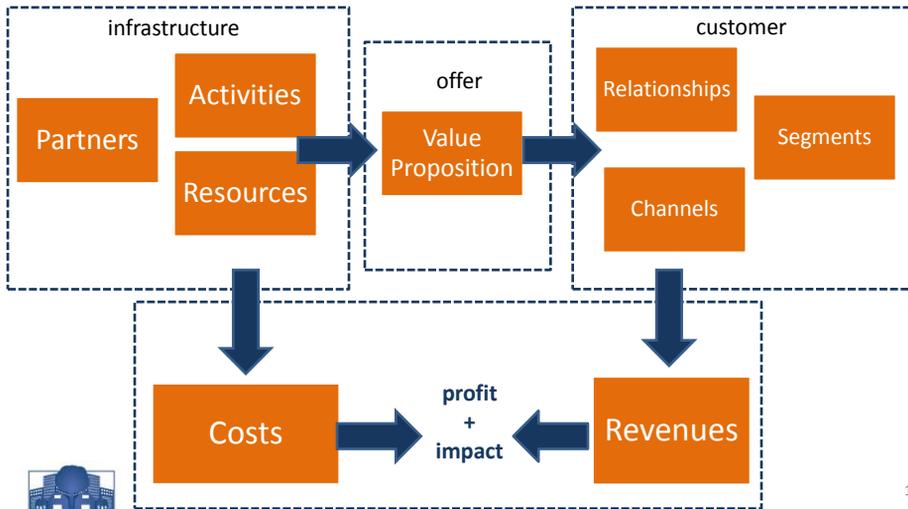


14



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## Business Model Canvas



15

## Some Business Model Questions to Ask Yourself

- Who are your most important customers and why?
- What do you offer them that is special, what is your competitive advantage in the marketplace?
- What loan, depository, or development products do you offer that offer value to your most important customers and drive them to you?
- Who are your most critical partners needed to attract and retain the customers you want?



16

## Poll Question

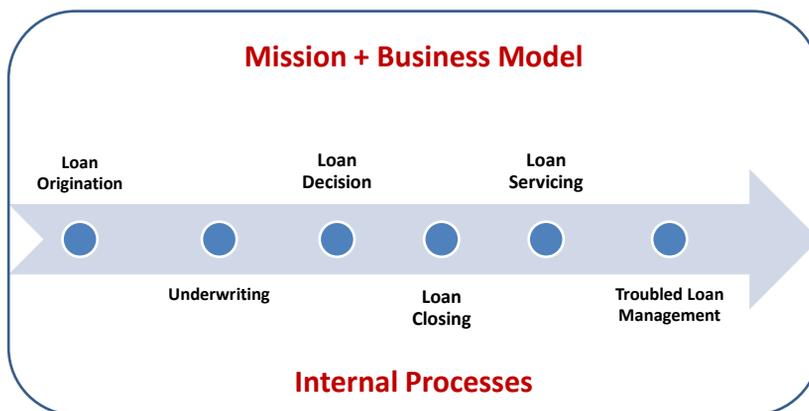
As you try to grow your loan portfolio, what represents the most significant barrier to increasing your lending?



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## Lending Life Cycle



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## The Infrastructure: Internal Processes

The lending life cycle – from loan origination through portfolio management – needs efficient **internal processes** for your lending to be:

- Rapid
- Accurate
- Consistent
- Reflect an appropriate level of risk
- Have capacity to generate data for ease of analysis and reporting



19

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## The Infrastructure: Managing Risk

- Managing risk is one of the most critical and elemental aspects of successful lending
- Effective risk management is essential for a CDFI's financial sustainability and ability to generate significant social impact in the communities it serves



20

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## The Infrastructure: Understanding Risk

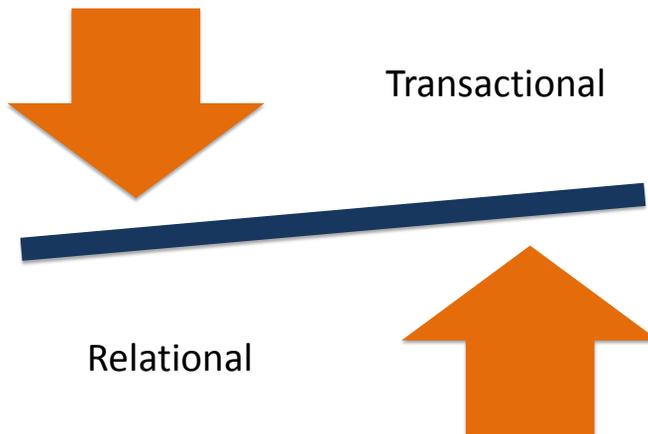


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## The Infrastructure: Thinking about Efficiency



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## The Infrastructure: Measuring Efficiency

### Cycle Time



- Lead to application
- Application to underwriting
- Underwriting to closing

### Input/Output



- Cost per dollar lent or per loan made
- Customer satisfaction
- Conversion rates



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## The Infrastructure: Lending Staff

As loan portfolios grow and lending becomes increasingly complex, it is critical that there is strong support for lending staff in order to meet production goals, manage risk effectively, and support job satisfaction for employees.



24

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## The Infrastructure: Supporting Lending Staff

Commitments to lending staff can include:

- Ensure a sufficient number of lending staff and support staff to originate, underwrite, service, and collect loans
- Ensure sufficient training opportunities and proficiency standards for lending staff



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## The Infrastructure: Training Opportunities

### Underwriters

- Portfolio analysis
- Loan structuring
- Lien perfection

### Lenders

- Cash flow analysis
- Credit report analysis
- Loan file postmortems

### Everyone

- Fraud awareness
- Economic trends
- Customer service



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## The Infrastructure: Technology

Technology provides critical support - or represents a serious barrier - to efficient internal processes necessary for effective lending



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## The Infrastructure: Technology

Lending technology must be:

- Affordable
- User-friendly, avoid duplication, be consistent
- Integrated with other back and front office operations
- Have capacity to easily generate reports for different audiences



28

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## Samples of Technologies to Improve the Lending Life Cycle

- Customer Acquisition
  - Customer Relationship Management Software
- Loan Application
  - Online loan applications
- Underwriting and Loan Approval
  - Credit evaluation grids, statistical scoring models, use of alternative credit data
- Loan Closing
  - Outsourcing document preparation
- Servicing and Collections
  - Mobile payment reminders



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## Poll Question

How satisfied are you presently with your current technology?



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## Poll Question

For those who are somewhat dissatisfied or very dissatisfied, why? Is your current technology too slow, hard to use or doesn't talk to systems, incapable of generating reports easily?

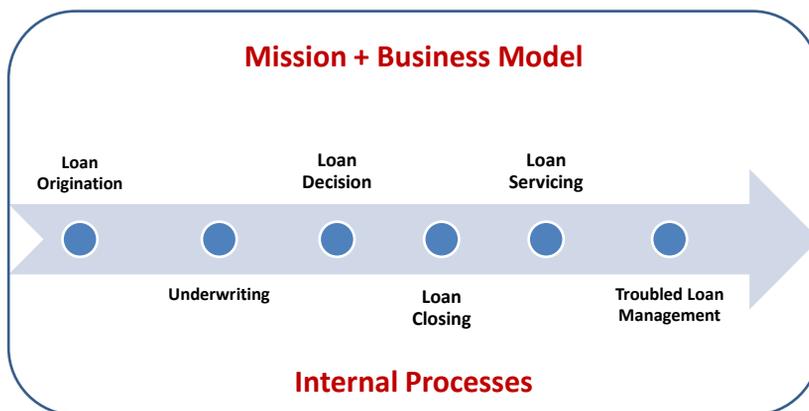
*(Choose as many answers as you want)*



31

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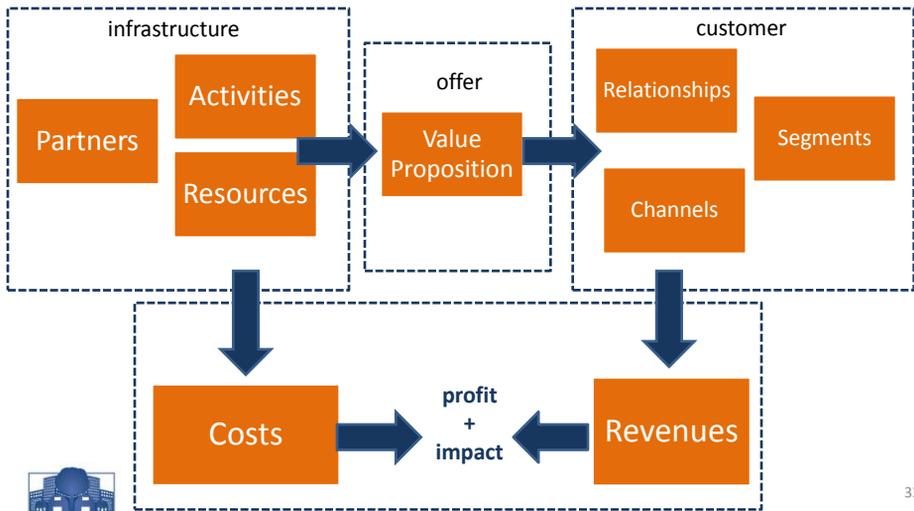
## Lending Life Cycle



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## Business Model Canvas



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## The Customer: Loan Origination and Customer Acquisition

- It is critical to thoughtfully identify who are your **most important customers** in order to accomplish your organization's broader mission and strategic priorities



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## Loan Origination and Customer Acquisition:

### The Who/What/What Exercise

- Who are we trying to get the attention of?
  - Which customer segment?
- What do they think about us now?
  - Where are they on the stage of customer experience?
- What do we want them to think about us?
  - What do they need to know?
- What do we want them to do?
  - What are our business objectives?



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## Poll Question

How clear is your organization on who are your most important customers and why?



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## The Role of a Marketing Strategy

- An effective marketing strategy helps to drive loan origination and customer acquisition
- A marketing strategy focuses on reaching the most important customers the organization is trying to attract and retain
- The marketing strategy is a strategic document that is part of the business model



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## Implementation of the Marketing Strategy – A Shared Responsibility

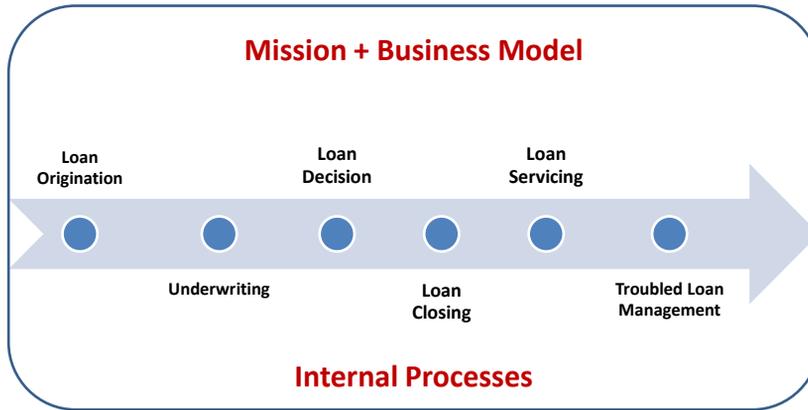
- Everyone in the organization plays a part in customer acquisition and loan origination through implementation of the marketing strategy
- A good marketing strategy helps an organization to strengthen its relationship with its customers:
  - Finding the customer
  - Listening to the customer
  - Responding to the customer
  - Keeping the customer



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# Lending Life Cycle



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## Lending Life Cycle - Underwriting

- It is critical that underwriting be fair, accurate, consistent, efficient, and reflect an appropriate level of risk for the organization
- Who qualifies for what loan products brings a key component of the mission to life



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## Typical Profile of Small and Emerging CDFI Loan Applicants

What kind of people and businesses apply for loans?

- All kinds!
- Generally start-up or emerging (microenterprise, micro-agriculture, small business, affordable housing and facilities development)
  - Limited capital
  - Limited historic cash flow
  - Limited collateral
  - Poor or limited credit history



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## Typical Loan Requests

Most loan requests are for:

- Microloans (\$1,000 up to \$50,000)
- Small business loans (\$50,000 to several million dollars)
- Affordable housing and facilities development (\$50,000 to several million dollars)



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## Typical Loan Products

### Typical loan products:

- Lines of credit
  - Finance short-term operational needs (inventory or supplies)
  - Interest-only minimum payments with 30 day clean-up period, annually renewable with review of financial condition
- Term loans
  - Finance longer-term investments (equipment or real estate)
  - Usually fully amortized
  - Flexible payment loans can be good fit for start-ups, seasonal micro and small businesses, and small farmers



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## Loan Policy

The most important internal document necessary for high quality loan underwriting is the loan policy



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## Why Loan Policies Matter

Good loan policies:

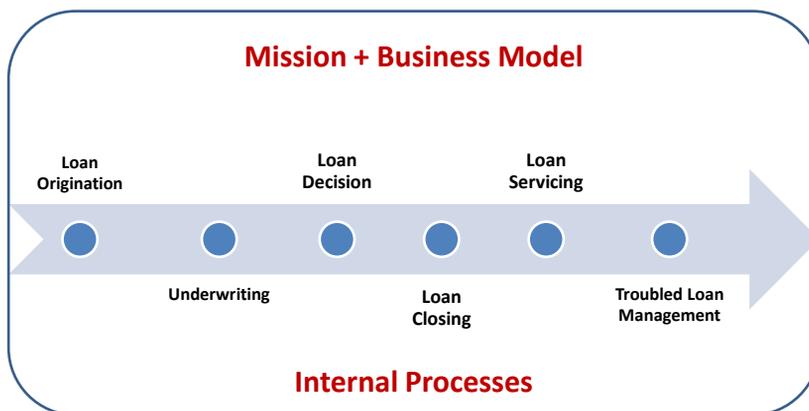
- Inform lending staff about the nuts and bolts of lending
- Ensure consistency and fairness in treatment of borrowers' applications
- Establish risk parameters and create a framework for oversight and regulatory compliance
- Provide organizational direction and consistency with the mission
- Are written down and are reviewed/updated annually



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## Lending Life Cycle



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## Poll Question

Does your CDFI have different levels of loan approval authority?



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## Loan Decision Process

The **underwriting phase** should be reflective of the loan officers' expertise, guidance in the policies and procedures, and an iterative vetting process. Once loans are at the **loan decision** stage, there should be sufficient infrastructure to support loan approvals, approvals with exceptions, and denials.



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## Loan Decision Process

At the heart of the **loan decision** phase, the CDFI's loan approvals and/or denials should be based on:

- Primary mission (desired impact or outcomes)
- Target market needs/demands
- Strategic plan
- Loan underwriting requirements
- Risk matrix
- Portfolio concentrations
  - Industries, borrowers, geography, size and type of loans



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## Loan Authorization Levels

The Loan Policies and Procedures, or a similar guidance document, should clearly outline who has loan approval authority. Examples of such authority may be based on:

1. Size of Loan
  - Senior staff (i.e., CCO approves loans up to \$50,000)
  - Loan Review Committee (approves loans up to \$500,000)
  - Governing Board (approves all loans greater than \$500,000)
2. Type of Loan
  - CCO has authority to approve all microloans
  - All NMTC transactions must be represented to the Governing Board

To help facilitate an efficient loan decision process, the size and/or type of loan should dictate the robustness of the credit memos.



50

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## Loan Review Committee

- One of the most important committees for any CDFI is the Loan Review Committee (LRC).
- The LRC is charged with:
  - Reviewing and approving (or denying) loans based on agreed upon underwriting criteria and well documented exceptions;
  - Approving and amending loan underwriting and servicing policies and procedures;
  - Approving any new loan products, underwriting criteria, and borrower profiles; and
  - Monitoring loan portfolio quality and performance.
- The LRC may be comprised of members of the Governing Board as well as non-affiliated persons such as bankers, attorneys, accountants, and representatives from mission-oriented organizations.



51

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## Loan Decision Process - Tips

To ensure that each LRC meeting is productive, the following should be considered:

- The policies and procedures identify the roles and responsibilities of the LRC;
- The LRC must meet frequently based on the CDFI's loan volume;
- The credit memos clearly articulate, identify any underwriting exceptions, and justify why the borrower should receive financing;



52

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## Loan Decision Process - Tips

To ensure that each LRC meeting is productive, the following should be considered:

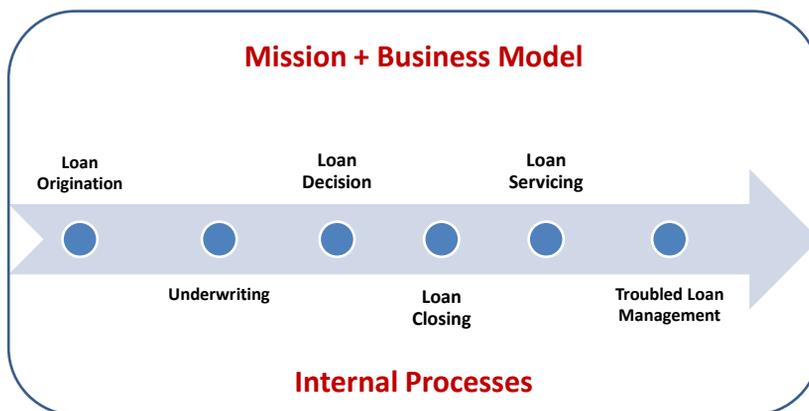
- The loan officers submit the credit memos and supporting documentation package to the LRC at least 2-3 business days prior to each meeting;
- The LRC must discuss each loan recommendation and either:
  - Approve the loan outright
  - Deny it
  - Postpone the decision pending additional information
- The minutes of the LRC meetings must highlight loan decisions and any discussions that transpired about the borrower.



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## Lending Life Cycle



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## Poll Question

Has your CDFI considered outsourcing some or all of the loan closing process?



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## Poll Question

Does your CDFI have a specialized loan technology platform to help automate the loan closing process?



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## Loan Closing Process

The ultimate goal of the **loan closing phase** is to ensure the CDFI has properly documented all of the legal requirements pertaining to the terms and conditions of each loan. Any mistakes during this phase can be very costly to the CDFI.

This phase will require frequent and transparent communication with the borrower.



57

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## Loan Closing Process

The loan closing staff must be keenly aware of:

- Special loan commitment requirements imposed during the loan decision phase
  - Do they reflect the CDFI's mission?
  - Are the conditions too onerous for the borrower?
  - How would such conditions impact the loan servicing department?
- Borrower's expectations related to timing of closing and any unique loan covenants
- Staffing, technology, and other types of resources available to facilitate the loan closing



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## Loan Closing - Tips

Tips to facilitate a seamless loan closing process:

- Create an environment of transparency between the CDFI and borrower.
  - During the **underwriting phase**, provide borrowers with a closing checklist to assist with document gathering.
- Properly document (via meeting minutes) any loan exceptions that are agreed upon during the **loan approval process**.
- Have standardized templates for legal documents.
  - Loan agreements, promissory notes, security agreements, etc.
- If required, engage legal counsel early to assist with the negotiating and/or structuring of any loan(s).



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## Loan Closing - Considerations

As part of the loan closing process, the CDFI must thoroughly evaluate the following:

- Which staff person(s) should be primarily responsible for the loan closing?
  - Loan officers vs. other
- Are there any bottlenecks with the transition between the loan approval and loan closing stages?
- Do the current systems and technology platforms allow for proper document management/gathering?
- Should the CDFI allow significant changes the standardized legal documents?
- How long does it take to close a loan and disburse loan proceeds?
- Should the loan closing process be outsourced?



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# QUESTIONS?



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## Resources

- Business Model Generation, Osterwalder & Pigneur, 2010.
- Sample of Technologies to Improve the Lending Life Cycle
- What's in Your Technology Toolbox? OFN Publication.
- Risk Rating Systems for Small Business Community Development Financial Institutions (CDFIs)  
[http://ofn.org/sites/default/files/TAMemo\\_RiskRatingSystems.pdf](http://ofn.org/sites/default/files/TAMemo_RiskRatingSystems.pdf)
- Portfolio Review: A Critical Element of Effective Portfolio Risk Management  
<http://www.opportunityfinance.net/store/downloads/2011PortfolioReview.pdf>



62

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## Sample Third-Party Technology Vendors

- Microloan Management Services: <http://www.acciontexas.org/mms/about/>
- OnDeck Capital: <http://www.ondeck.com/>
- Inventure/Insight: <http://www.inventure.org/using/learn-about-insight>
- Demyst data: <https://demystdata.com/>
- Cignifi: <http://www.cignifi.com/en-us/>
- Yodlee: <http://www.yodlee.com/>



63

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## Strengthening Small and Emerging CDFIs Webinar Series

April  
24

- **Lending Life Cycle Part II: Loan Servicing and Troubled Loan Management**

– *Ginger McNally and Tabitha Atkins, OFN*

*Upcoming webinar registration and past webinar recordings can be found at:  
[The CDFI Fund's Virtual Resource Bank.](#)*



64

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# CDFI Fund's Virtual Resource Bank

www.cdfifund.gov/what\_we\_do/Strengthening\_Small\_and\_Emerging\_CDFIs\_Resource\_Bank.asp

- WHO WE ARE
- WHAT WE DO
- IMPACT WE MAKE
- NEWS & EVENTS
- HOW TO APPLY

## COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

UNITED STATES DEPARTMENT OF THE TREASURY

### Strengthening Small and Emerging CDFIs Resource Bank

The resources for this topic can be found below. To view all of our available Resource Banks, click [here](#).

**I. Training Curriculum:**

- Models for Growth – What Works
- The Logic Model as an Outcome-Based Project Management Framework
- The Four Stages of Organizational Growth
- Business Model: External Environment
- Managing and Negotiating Change
- CDFI Action Plan
- Leading Organizational Change

**II. Training Webinars:**

- Coming Soon

**III. Additional Resources:**

- Analysis of the CDFI Industry Landscape
- CDFI Operations
- Tools for Greater Community Development Impact

65



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